

Personal Guarantees

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In today's volatile marketplace, the existence of a personal guarantee may provide the only viable basis of collecting outstanding receivables from a corporate obligor experiencing financial difficulty. A personal guarantee creates a greater potential of recovery for the collection of outstanding receivables. The guarantee, as an effective tool for collection, can be maximized when proper attention in drafting, execution and monitoring is exercised. However, in the end, the effectiveness of a personal guarantee is directly dependent upon the financial capability of the guarantor.

2 Types of Personal Guarantees:

- 1) Guarantees of Payment: allows a creditor to proceed directly against the guarantor without the necessity of taking any action against the primary obligor.
- 2) Guarantees of Collection: a creditor must first proceed directly against the primary obligor and only if the debt cannot be collected after the exercise of due diligence (the commencement of legal proceedings against the corporate guarantor and the result being the obtainment of an uncollectible money judgment) can collection commence against the guarantor.

Key Elements of a Solid Guarantee

- 1) A creditor should specify that the guarantee is one of payment and should specifically refer to past, present, or future indebtedness.
- 2) It should be a continuing guarantee and remain in effect until written notice of an election to terminate is given.
- 3) The signature of the guarantor should be notarized to insure against any future questions regarding the genuineness of the signature. There should be no designation of title or corporate capacity.
- 4) A provision for the recovery of collection expenses and attorneys fees should be inserted.
- 5) No prior notice or other condition precedent should exist before action can be taken against the guarantor.
- 6) The guarantee should bind the successors and assigns of the individual guarantors.
- 7) The social security number and residence (street address, not P.O. Box) of the guarantor should be included.
- 8) The guarantee should be dated and all blanks filled in.

-Credit Manager should also attempt to obtain a financial statement of the guarantor to evaluate the financial capabilities of the guarantor. In the event that collection activity is activated against the guarantor the financial statement will serve a variety of purposes, including disclosure of the guarantor's assets.

When can the Guarantee be Obtained/Special Problems

Personal guarantees of corporate obligations are generally obtained at either 1) the inception of the business relationship between the supplier and purchaser or 2) at a subsequent time when the creditor has lost confidence in the customer's ability to repay a debt incurred in the business relationship.

Special problems arise when the guarantee is signed subsequent to the inception of the business relationship. In order for a personal guarantee to be binding, value or consideration must be received (e.g. future extension of credit by the supplier to the purchaser, the waiver or postponement of a legal right by the creditor). If there is no value or consideration given by the creditor when a personal guarantee is signed subsequent to the inception of the business relationship, the personal guarantee will be deemed to be a gratuitous document and not legally binding upon the guarantor.

Moreover, the statute of limitations that applies to actions to recover damages for goods sold and delivered is 4 years [Uniform Commercial Code Sec. 2-725(1)]. The personal guarantee does not extend or effect this time in any manner. Specifically, the personal guarantee does not generally give rise to an independent legal right and the ability to enforce a guarantee is directly dependent upon the validity of the underlying corporate indebtedness.